Finalists ponder last bids for Treasury Holdings' Castle Market portfolio

By James Wallace - Tuesday, April 16, 2013 16:05

Three finalists have emerged in the final bidding round for the former Treasury Holdings' 16-strong Castle Market portfolio, with cash offers from each London & Regional and Kennedy Wilson competing against a CMBS restructuring proposal from Northwood Investors for the predominantly Dublin office portfolio.

NORTHWOOD INVESTORS

Hypothekenbank Frankurt, which is Commerzbank's rebranded Eurohypo, the special servicer of the matured Opera Finance (CMH) CMBS loan, and its adviser Cairn Capital, cut the shortlist to three on Friday, with KKR leaving the blind auction process.

CoStar News understands that two rival cash offers from London & Regional and Kennedy Wilson have progressed to the final round, to retain price competitiveness with Northwood's restructuring proposal and as insurance against the danger of one of the cash bids falling away before final bids are due in early May.

Northwood Investors, which *CoStar News* revealed acquired the out-of-the-money €85m junior loan under the Opera Finance (CMH) CMBS from NAMA in January, has put forward a CMBS restructuring proposal which, effectively, amounts to a re-securitisation.

CoStar News understands that Northwood's restructuring proposal includes a fresh four-year loan, offering re-priced class A coupons at around 350 basis points, along with a sub €50m fresh equity injection into the deal.

Cash today versus larger recovery tomorrow

London & Regional and Kennedy Wilson's cash offers, thought to be close, are priced relative to the most recent non-public valuation, dated towards the end of last year, and are seeking to compete with Northwood's restructuring proposal which offers bondholders the prospect of greater ultimate recovery, particularly for the currently out-of-the-money junior class Cs and Ds noteholders.

The last public valuation was cited as €270.4m, as at 28 February 2012, but this was conducted internally by Treasury Holdings. Since this time, a recovery in capital values in Dublin offices has slowly began, with optimism growing that a deeper turnaround in prospect for Ireland's battered commercial property market will begin in its capital city.

NAMA's sale of the junior loan to Northwood special purpose vehicle NW Finance Company S.A.R.L. – thought to be for as little as €100,000 – gave Northwood an advantage in securing a restructuring and legal final extension of the CMBS notes.

Owning the junior loan gave Northwood a seat at the table, and a head start on others seeking to bid for the loan, assets or whole portfolio. In addition, Northwood has a veto on other restructuring proposals, which typically require the consent of all lenders.

Northwood could potentially have blocked rival CMBS restructuring proposals, which perhaps explains why it is two rival cash-only offers which have progressed through to the final round.

The sub €50m equity injection would pay down bondholders to construct a re-structured securitisation, similar to TPG and Patron Capital's re-securitisation of the Uni-Invest CMBS, secured by a portfolio of Dutch secondary and tertiary properties.

A four-year loan extension – which would require an extension of the legal final maturity of the CMBS notes out to 2019 – would enable Northwood to implement its business plan, which is expected to include specific asset management and asset repositioning strategies for some of the larger assets, for which major leases are due to mature.

Based on the current public internal valuation for the Castle Market portfolio of €270.4m, the value breaks in the class Bs. The successful implementation of Northwood's asset management plans could see value recoveries improve into the class Cs, for which there are €40m worth of notes, and possibly the Ds, for which there is €35m worth of notes.

By contrast, the London & Regional and Kennedy Wilson cash offers provide day one cash paydown to bondholders, but are thought to crystallise deeper losses for the junior securitised notedholders, possibly into the class Bs.

A decision between the counter offers is expected to be made by Hypothekenbank Frankurt, its adviser Cairn, and the assembled all-Class ad-hoc steering committee which was assembled two months ago.

Embedded tax liability further complicates decision

But either decision – the Northwood restructuring or one of the two rival cash offers – is complicated by former owners Treasury Holdings embedding the capital gains tax liability for the purchase of the portfolio eight years ago into the CMBS deal, to be paid when the deal matures.

At the time of the securitisation, based on the Castle Market portfolio's then €500.4m value, the embedded capital gains liability was €52.16m, according to the original CMBS prospectus, which has fallen considerably, proportionally with value.

Currently the tax liability – which is thought to rank super-senior to the securitised loan – is around €20m, which is payable upon the collapse of the CMBS deal.

This liability would be crystallised in the event of one of the cash offers winning, while could potentially be delayed under the Northwood restructuring proposal and possibly crystallising a larger liability at the end of the extended CMBS.

Castle Market portfolio's asset management potential

While the leases in the portfolio are running down, all three finalists are attracted to the Castle Market portfolio for its asset management potential.

The portfolio includes: the 145,000 sq ft Stillorgan Shopping Centre in Dublin, for which anchor tenant Tesco has a September 2016 break clause; four Russell Court office, across 137, 801 sq ft, let to KPMG whose lease expires in 2015; and the Irish Training and Employment Agency headquarters in 27/33 Upper Baggot Street, whose lease expires this year.

Trading for the first quarter of this year at Stillorgan shopping centre was positive with the majority of tenants reporting improved footfall on the same period last year: January was up 6.2%, February up 4% and March up 1.8%, according to the quarterly investor note published yesterday.

"The repositioning of the centre during 2012 continues to provide a strong platform for current letting activity," wrote Hypothekenbank Frankurt.

The valuation of the Castle Market portfolio has oscillated wildly over the last eight years.

DTZ Sherry valued the portfolio at €500.4m for Treasury Holdings at the time of securitisation in December 2005, which then rose to €570.3m exactly three years later in December 2008 – in spite of the onset of the global financial crisis which sent Irish commercial property values tumbling.

Just 11 months later in November 2009, NAMA – which by this time had taken control of the €85m junior loan as part of all debt held by Treasury Holdings, founded by Irish developers Johnny Ronan and Richard Barrett – commissioned DTZ Sherry to re-value the portfolio, this time recording a valuation of €342.2m – 40% lower.

The €270.4m internal valuation was the third by Treasury Holdings, which succumbed to insolvency last October under property debts estimated at €2.7bn - €1.7bn of which held by NAMA.

All parties declined to comment.

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